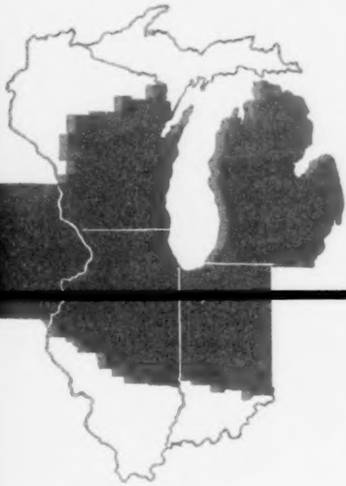
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1959 March

Contents

THE Trend OF BUSINESS

During the early months of 1959 the business recovery was proceeding on a broad front. Some measures of activity, such as personal income, retail trade and construction, had established new highs. Others, including industrial production, corporate profits, business investment and employment, were still below earlier records but were rising.

Comparisons appear especially favorable on the familiar basis of year-to-year change. In part, this is because the opening months of 1958 were depressed from the high levels of the previous year.

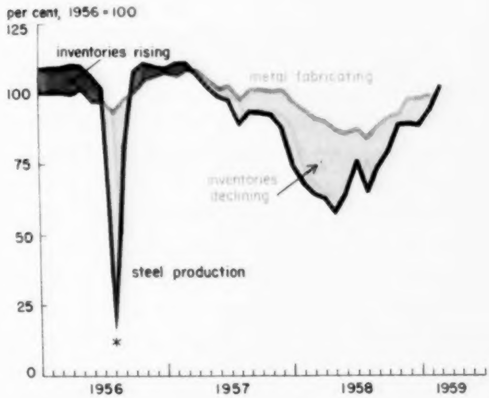
Unemployment eases in Midwest

Despite the slower rise in employment than in business sales and industrial output since last spring, labor markets *are* strengthening gradually. A recent survey by the Bureau of Employment Security indicates substantial improvement currently in the labor markets in three District cities—South Bend, Peoria and Milwaukee. Rising employment in automobiles, auto parts, farm machinery and construction machinery were major contributing factors. Since July 1958, the weakest month in terms of employment, ten of the District's major labor markets have shown substantial improvement.

The Bureau classifies labor markets periodically, taking into account employment prospects as well as current labor market conditions. One important criterion used in the classification is the percentage of labor force unemployed. The over-all evaluation of each major labor market is reflected in a letter designation which coincides roughly with the percentage unemployed, as follows: A, less than 1.5 per cent; B, 1.5 to 3.0 per cent; C, 3.0 to 6.0 per cent; D, 6.0 to 9.0 per cent; E, 9.0 to 12.0 per cent; and F, over 12.0 per cent. The January 1959 classification for major cities in the Seventh Federal Reserve District is given below, along with the classification six months earlier. Those centers which have shown improvement are starred.

	July 1958	January 1959
Illinois		
Chicago	D	D
Quad Cities	C	C
*Peoria	E	C
Rockford	C	C
Indiana		
*Fort Wayne	E	D
*Indianapolis	D	C
*South Bend	F	D
Terre Haute	D	D
Iowa		
*Cedar Rapids	C	B
Des Moines	C	C
Michigan		
Detroit	F	F
*Flint	F	D
*Grand Rapids	F	E
Kalamazoo	C	C
*Lansing	E	D
Muskegon	F	F
Wisconsin		
*Kenosha	D	C
Madison	C	C
*Milwaukee	D	C
Racine	D	D

Steel inventory liquidation may have ended in February



*Production curtailed by strike

Inventory adjustment in durables

Total business sales, nationally, rose substantially in December on a seasonally adjusted basis. Another increase doubtless occurred in January.

Total business inventories increased slightly in November and December of 1958. These were the first increases since August 1957. All of the rise was accounted for by auto dealers whose stocks had been very low in the autumn. Inventories other than those of auto dealers declined slightly in November and December as sales continued to exceed output. It appears, therefore, that inventory accumulation can be expected to be an important supporting factor for output and employment for some months to come.

Inventories had been growing moderately at the onset of the business decline in 1957 but were being reduced at a rate of over 9 billion dollars per year in early 1958. This was the most rapid liquidation in the postwar period. Over 80 per cent of the inventory liquidation during the 1957-58 adjustment took place in the durable goods lines.

Despite a rapid rise in production, inventories of durable goods manufacturers in the final two months of 1958 appear to have declined slightly. "Purchased materials" in the hands of these firms were off 200 million dollars, or 3 per cent, indicating that production was picking up faster than raw materials were being acquired.

Steel in the limelight

The most dramatic industrial development in recent weeks has centered in the steel industry. In November and December, steel output reached 2 million tons per week—up more than 50 per cent from the low point last spring. By February, the weekly output had moved up another 20 per cent, to 2.4 million tons and was still rising. Steel output in mid-February was still slightly below the previous record in early 1956 and still 14 per cent below estimated capacity.

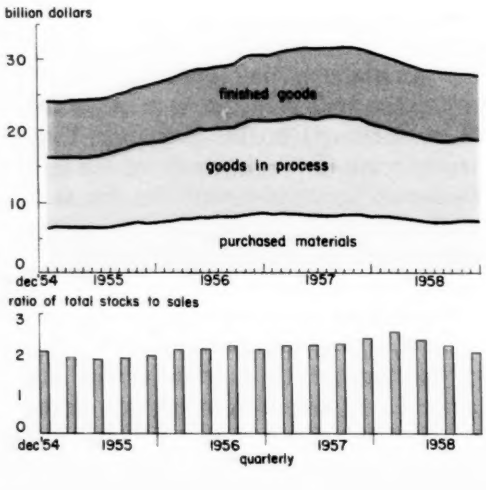
Some steel firms in the Midwest have been operating practically at capacity in recent weeks. Aside from wide flange beams and some other structurals, all types of steel once again are on "informal allocation" in the Chicago area. Order books of some firms are filled through the second quarter. Thus, the steel industry, which was thought to have substantial "excess capacity" for the foreseeable future, is experiencing demand for some items in excess of available supply.

There are two reasons for the rapid rise in steel demand: first, the need to supply current working requirements of steel processing firms; and second, the desire to build up inventories as a precautionary measure in the event a strike were to restrict availability of the metal after midyear.

Direct information on the consumption of steel by users, or the extent of steel inventories in the hands of users, is lacking. However, consumption can be inferred by the rate of activity in the steel-using industries, and changes in inventories can be approximated by comparing steel output with this measure of steel usage. One such rough comparison is shown in the accompanying chart which compares steel output with production in the broad grouping of "metal fabricating" industries.

During 1956, steel inventories are believed to have been about the same at the beginning and the end of the year. In other words, output was equal to utilization. Using that year as a base, therefore, some idea can be obtained as to the periods since then in which inventories were rising or falling. Liquidation of steel inventories apparently began in March of 1957. In the following months, activity in steel-using industries declined but not nearly so sharply as steel output. The rate of liquidation was most rapid in the early months of 1958. Thereafter, the gap between production and consumption narrowed, but net reductions in steel inventory probably continued through January of 1959. In February, the pendulum was swinging back toward accumulation.

Hard goods producers' inventories decline through 1958



Consumer buying at record level

Retail trade in January remained at the 17.6 billion dollar record level, seasonally adjusted, established in December. Reflecting the strong finish in the closing months of 1958, total retail trade during the year just about equaled the 1957 figure. The lack of spark in total retail sales during most of 1958 reflected primarily the reduced activity at automotive stores. Auto and truck dealers have accounted for 15 to 20 per cent of total retail sales in recent years. Last year, sales of these firms were 12 per cent below 1957. Nonautomotive retail trade, on the other hand, was about 3 per cent *higher* than in 1957. Moreover, nonautomotive retail sales exceeded 1957 in every month during 1958.

Although there have been some expressions of disappointment over the sales of new autos so far this year, it appears that in January the dollar volume of sales of automotive dealers was the highest on record, slightly exceeding the same month of 1957, the previous high for any January. Dealers delivered an average of 16,500 domestically-produced passenger cars to customers each selling day in January. This was 13 per cent more than in the same month a year earlier but was far below each of the three previous years. The relatively strong showing of total sales of automotive dealers reflects the rise of prices and gains in sales of used cars, foreign cars and trucks.

A new era in foreign trade?

Developments in foreign trade and international finance attracted a widening circle of interest during 1958. Exports of U. S. merchandise declined by 18 per cent from a year earlier, but United States imports remained relatively stable despite the lower level of business activity.[1] For the entire year, foreign nations purchased 2.25 billion dollars of gold from the U. S. Treasury, while adding only about one-third that amount to their holdings of dollar balances and interest-bearing securities. And, at long last, several nations took steps that brought them closer to achieving a goal of United States foreign economic policy since the end of World War II—the full restoration of free convertibility of foreign currencies.

Some observers, especially overseas, have interpreted these developments as indicating that United States manufacturers and the dollar are losing their positions of leadership in world trade. The decline in U. S. exports is taken by such observers as evidence that rising costs and prices in this country have resulted in many firms here pricing their products out of world markets. These observers point to the preference of foreign nations for gold in 1958 and the strengthening in the exchange rates of other currencies relative to the dollar as evidence of a growing attitude that a continued deterioration in the United States position is likely. A closer look at these developments and the causes behind them, however, tends to ameliorate these fears.

[1]At the time of publication, the latest data available on 1958 U.S. imports and exports were through September, and statistics in this article are based on developments through that month. Earlier-year comparisons are made with corresponding months.

Trade balance still favorable

Despite a drop of almost a fifth in U. S. merchandise exports last year and even with continuing restrictions in many countries on imports from the United States, this country continued to sell more goods to foreign customers than we bought abroad. For the first three quarters of 1958, seasonally adjusted merchandise exports totaled 12.2 billion dollars, 2.7 billion more than United States merchandise imports. Although well below the 4.9 billion trade gap in comparable 1957 months, the export surplus amounted to over a fifth of United States overseas sales.

Merchandise trade, however, is only one of several types of transactions generating international payments and receipts. Not only does the United States typically run a surplus in its merchandise trade position, but, as a major international lender and investor, income on this country's investments abroad is far in excess of foreign earnings on investments in the United States. Through September last year, payments of interest and dividends to the United States from other countries topped the comparable United States outlays by 1.6 billion dollars.

On the other hand, new United States investments abroad supply foreign nations with dollars that can be used to pay for goods and services obtained from this country. In recent years, the bulk of investments have been going to Canada and South America, mainly for resource development. Foreign investment in the United States, however, is rela-

tively small. In the first nine months of last year, the United States added 2.4 billion, seasonally adjusted, to its overseas investment holdings. This dwarfs the growth in foreign investment in this country, which in recent years has averaged between 200 and 300 million dollars.

Another major source of dollars to foreign countries has been the expenditures made abroad for personnel and military installations overseas. Salaries paid to troops and civilian Defense Department employees stationed in other countries and goods and services purchased locally for the maintenance of our overseas defense establishments amounted to 2.5 billion dollars in the January-September period in 1958—exceeding even the volume of U. S. investments overseas.

Also available to foreign nations were 1.8 billion dollars, seasonally adjusted, in United States grants, excluding grants for military purposes, and 600 million representing the amount spent by United States residents traveling abroad in excess of outlays by foreign visitors to this country. As a result of all these transactions, payments to foreign nations topped receipts from foreign nations by 2.3 billion dollars in the January-September period of last year. As is indicated in the chart, five-sixths of this total was used to buy gold, the remainder supplemented holdings of dollar balances and United States securities.

Material sales dominate drop

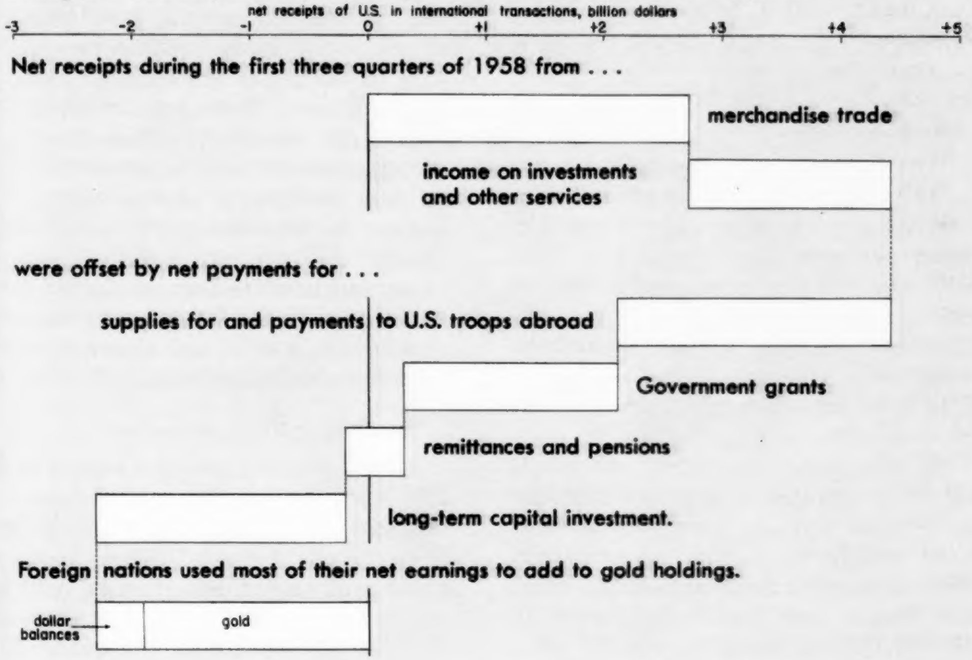
In virtually every major category of U.S. merchandise, exports declined in 1958. The biggest declines were concentrated in raw or semifinished industrial products — crude materials falling by 33 per cent and semifinished goods by 38 per cent, together making up two-thirds of the over-all decline. In contrast, exports of finished products declined only 9 per cent from the 1957 level, with foods registering a similar decline.

Two factors were primarily responsible for the reduction in the overseas sales of nonagricultural products last year. (For a discussion of farm commodities, see article entitled "Agricultural Exports at High Level —But Slipping?" in the February 1959 issue of *Business Conditions*). First was the slackening in economic expansion in many Western European nations. The capital goods and inventory boom that had characterized the previous few years in most of Europe slowed down. This curtailed the demand for industrial raw and semifinished materials, for which the United States is sometimes a marginal supplier. Moreover, the tapering in investment itself served to cut foreign demand for U. S. machinery and equipment.

The second major cause of the slump in United States exports last year was the end of the extraordinary European demand for petroleum from the Western Hemisphere following the reopening of the Suez Canal. After the canal was closed in late 1956, nations that had depended upon oil from the Near East were forced to turn elsewhere for supplies. The United States, Venezuela and Canada all boosted petroleum exports. In the first six months of 1957, U. S. oil exports were more than double such sales during the same 1956 months.

Thus, petroleum and coal exports accounted for a fourth of the decline in U. S. overseas sales from 1957 to 1958. Another 30 per cent represents the 700 million dollar drop in metals shipments, including iron and steel products and scrap, and copper, aluminum and other nonferrous metals. These two categories — fuel and metals — made up less than a fourth of the United States' 1957 export volume, but were responsible for more than half of the 1958 decline.

Despite U.S. export surplus, payments abroad exceed receipts



On the other hand, while exports of finished manufactured goods declined, the drop for most items, though significant to U. S. producers, was much smaller than in unfinished goods. Truck sales abroad fell one-third and farm machinery exports decreased 16 per cent, but shipments of industrial machinery declined only 7 per cent, electrical equipment 6 per cent, and civilian airplanes and chemicals both down 4 per cent. Exports of office machines were about stable while sales of railway equipment increased 42 per cent.

In order to weed out the influence of the unusual circumstances surrounding 1957 and 1956 developments, exports last year may be compared with similar 1955 months. The perspective provided by this comparison is substantially different. As indicated in the accompanying chart, shipments abroad in almost all categories of items were greater last year than in 1955. Total nonmilitary exports increased 18 per cent, compared with a 10 per cent gain in the nation's total production of goods and services. Despite a 140 million dollar decrease in 1957 from the preceding year, exports of industrial machinery in 1958 were still 50 per cent above the 1955 level. Over the three-year period, railway equipment sales doubled and civilian aircraft was up by 70 per cent. Office machinery, chemicals, electrical apparatus, coal,

textiles and grain exports all increased by a fifth or more. The major offset to these increases from 1955 to 1958 was a decline of 120 million, or 14 per cent, in exports of automotive vehicles.

Auto exports down, imports up

The drop in auto exports in 1958 marks the third consecutive year in which foreign sales have declined. Over 210 thousand passenger cars were shipped abroad in 1955, just about matching the previous high of 1951. In 1956 and 1957, auto exports declined by 17 and 19 per cent, respectively, to the lowest level since 1952. Sales abroad in 1958 fell an additional 13 per cent from the comparable year-ago months.

The persistent decline in U. S. automobile exports over the past three years has resulted mainly from increasing penetration of many world markets by foreign manufacturers. This is reflected on the domestic scene, where auto imports have been rising sharply. In 1954, the United States imported 36 thousand cars. By 1957, shipments into this country totaled 265 thousand units, an increase of more than 600 per cent in three years. For the first nine months of 1958, auto imports exceeded 300 thousand cars, already well above the number imported in all of 1957.

The extent to which foreign auto producers have captured a bigger slice of the total car sales is indicated by the following:

	1955	1957
U. S. production as per cent of world output	71	62
U. S. exports as per cent of world exports	18	10

From 1955 to 1957, auto production in the United States declined 23 per cent, while output elsewhere climbed 19 per cent.

The big boost in United States auto imports and probably the relative strengthening in the position of foreign producers in overseas markets appear to be based primarily on the appeal of the product itself, rather than on the ability of foreign producers to undersell United States firms. Many smaller foreign cars, for example, claim greater operating economies and maneuverability than do most domestically produced autos. The success of the domestically manufactured "smaller cars" tends to confirm the current importance of these features. Should plans by the major United States auto producers to manufacture a small car materialize, auto imports could be significantly affected.

Declines in most other imports

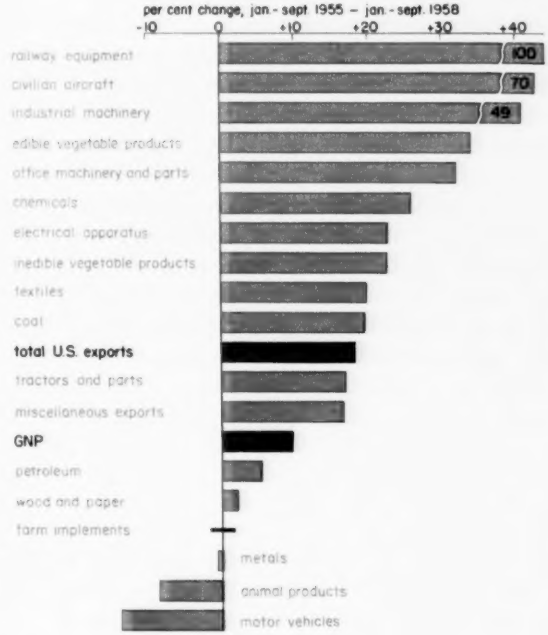
Almost matching the 140 million dollar gain in auto imports during 1958 was a 120 million dollar boost in United States imports of meats—an increase of 100 per cent. Reduced marketing of domestic cattle and the resultant higher meat prices were mainly responsible for this sizable increase in food imports.

The gain in the value of auto and meat imports in 1958 offsets in part declines recorded in other products. Imports of many raw and semifinished materials dropped with the slowdown in domestic manufacturing activity. Iron ore, for example, declined 19 per cent from a year ago and iron and steel-mill products were down about 10 per cent. Among the nonferrous metals, copper, nickel, tin and zinc, all recorded sizable decreases in the *volume* of imports; in terms of *value*, the declines were greater, being accentuated by price declines. The value of aluminum ore and bauxite imports remained stable, while decreases in lead prices resulted in dollar outlays remaining at the 1957 level, despite a 27 per cent increase in the volume of shipments coming into the coun-

try. Other commodities registering declines in value of imports included wool, down one-third and newsprint, down a tenth.

Petroleum imports, which had increased rapidly in recent years, were held to their 1957 level by a Government program of import restrictions. From 600 million dollars in 1951, the value of petroleum imports had climbed to 1,550 million in 1957, a rise precipitated by the fact that oil from the prolific fields of the Near East and Venezuela can be delivered in the United States at a lower cost than domestic petroleum can be produced.

Exports have risen faster since 1955 than total output of goods and services



A competitive world

Even though shifts in United States foreign trade in 1958 were due primarily to a fall off in the extraordinary demand from abroad for raw materials and capital goods the year before, rather than increased price competition from foreign producers, this should not obscure or minimize the fact that many domestic firms have been significantly affected by increasing competition from foreign producers in their quest for both overseas markets and domestic sales. The gain in the position of foreign producers is in part the natural result of the rehabilitation and modernization of war devastated manufacturing plants and equipment, in many instances with the aid of the United States. Most countries that suffered great destruction have now restored their productive facilities, utilizing advanced and efficient machinery and methods. Moreover, they have reached the point where producers can not only more adequately meet domestic demand but also devote effort to development of export business. The improved ability of foreign nations to compete more effectively in world markets has indeed been a normal concomitant to the objectives of our foreign policy of promoting economic recovery and self-reliance on the part of friendly nations.

Rising wages and domestic prices are frequently cited as evidence that the United States producers have lost competitive position in world markets. In both cases, however, the increases over the past few years in the United States appear to have been relatively smaller than in most other in-

dustrial nations. From 1953 to 1957, hourly wages for manufacturing workers in the United States increased 17 per cent. Based upon available evidence for the same period, wage rates rose 18 per cent in Canada, 20 per cent in Italy, 26 per cent in Japan and over 30 per cent in Western Germany, France, the Netherlands and the United Kingdom.

The "cost of living" as reflected in the index of consumer prices in the United States has similarly shown one of the lowest increases of any industrial nation over the past five years. At mid-1958, the consumer price index had increased 8 per cent from the 1953 average. Comparable figures for other countries show:

	Per cent increase from 1953		Per cent increase from 1953
United Kingdom	21	Japan	9
Sweden	19	Belgium	9
Netherlands	18	Canada	8
Austria	15	United States	8
W. Germany	10	Switzerland	7

While these comparisons may help put the problem into a clearer perspective, it is very difficult to pinpoint the changes in relative production and distribution costs of firms in different countries. On the one hand, a 20 per cent increase in wage rates will have a stronger influence on costs in a country using a high proportion of labor than in one where capital plays a more important role in the productive process. On the other hand, nations making rapid strides in mechanization may realize large gains in efficiency. This in turn may permit a more rapid increase in wage rates without a corresponding effect on product prices than in the already highly mechanized nations.

Increasing competition from foreign producers may have had some influence in restraining price rises in this country. First, as a result of imports, some items were no doubt available at lower prices than they otherwise would have been. Also, imported goods add to the volume of total goods available for purchase, thus drawing off some of the price pressures within the economy. Finally, insofar as foreign competition promotes efforts toward increased efficiency by domestic producers, resources may be used more effectively, with benefits to consumers both here and abroad.

Producers in all countries, of course, must always be prepared to face shifts in the composition of exports and imports in response to market forces of supply and demand. With shifts in relative costs among countries, the products which each nation can profitably sell to others may also change. A free market in international trade entails the same kinds of adjustments by individual firms and industries to new products, new methods and new supply conditions abroad as result from such changes domestically.

The glitter of gold

If no balance of trade crisis is imminent for the United States, why have foreign nations been eager to add to their gold holdings rather than dollar balances? Does this indicate loss of confidence in the dollar and expectation for an increase in the United States Treasury purchase price for gold?

Despite the substantial publicity given to the large-scale gold purchases by foreign nations, there has not been any significant conversion of dollar holdings into gold. Rather, the gold purchases have been made largely from funds earned currently by other countries. Foreign holdings of bank deposits in the United States, together with holdings of short-term Treasury securities and banker's acceptances, totaled 16.0 billion dollars at the end of last October, compared

with 15.2 billion at the start of the year. Thus, dollar balances and securities apparently continue to be considered by foreigners as an entirely satisfactory repository for liquid funds.

The 800 million dollar increase, however, compares with gold purchases over the same period totaling over 2 billion dollars. This tendency for foreign nations to convert a large share of their additional funds into gold was probably affected by three factors. The biggest share of the gain in gold holdings was by European nations. These countries as a whole typically hold a substantial proportion of their reserves in gold. Second, some nations, England for example, that made the largest additions to their gold and dollar holdings last year had experienced a drain in their gold stock in the last half of 1957 that was no doubt being replenished in early 1958. Third, the decline in interest rates in the United States in the first half of last year decreased the advantage to foreigners of holding interest-bearing securities over a nonearning asset such as gold.

The 2.3 billion dollars in gold purchased by foreigners in 1958 reduced the U. S. gold stock by 10 per cent. Yet, the domestic gold supply is still well in excess of that required by law as a monetary reserve. According to current statute, the amount of gold certificates issued by the Treasury to the Federal Reserve must be equal to at least 25 per cent of the combined total of Federal Reserve notes outstanding and deposits at Federal Reserve Banks. The required ratio was decreased by about a third in 1945 by Congressional action. With this combined total now at about 47 billion dollars, the U. S. gold stock, at 20 billion, remains well above the required 12 billion dollar level.

Behind convertibility moves

Moreover, the increase in foreign gold and dollar reserves last year was a primary factor permitting the recent increases in currency convertibility adopted by most European countries. These measures bring the international financial community closer to the goal of free interchange of currencies. The changes indicate that the nations involved either have put or are intent upon putting their monetary houses in order. Thus, the developments of the past year can more appropriately be considered a partial fruition of long and strenuous efforts to achieve sound currency and trade policies on the part of friendly countries than as a weakening in the position of the dollar.

The executive messages

In the early weeks of each new year, the news from Washington is dominated by Presidential reports and recommendations. By law and by tradition, the President sends a series of executive messages to the Capitol in quick succession following the convening of the Congress. This year, the three annual messages—State of the Union, the Budget for the next fiscal year and the Economic Report—have been unusually similar in their

content. In all three documents, the President has given heavy emphasis to the financial position of the Government and to the steps which he believes must be taken if the Budget is to be balanced in the fiscal year beginning next July 1.

This emphasis upon the Government's own fiscal performance reflects the country's recent economic experience. The rapid recovery from the 1957-58 recession and the outlook for a prosperous year ahead once again pose the question of whether the American economy can simultaneously enjoy prosperity, growth and price stability. The gradual inflation during the 1955-57 boom was not reassuring, and its memory is evident in the three messages. Moreover, the economy's shift back into forward speed accompanies a very large Budget deficit for the current fiscal year, much of which is a legacy from the recession months.

Reviewing and previewing

The *State of the Union* message, which dates from the earliest days of the Republic and is presented within a few days of the

The Budget for 1960 — major changes forecast by the President, fiscal 1959 to fiscal 1960

EXPENDITURES	Change, 1959 to 1960 in Budget terms (billion dollars)	Change, 1959 to 1960 in cash terms (billion dollars)	Main reasons for change
Major decreases —			
Additional U. S. subscription to International Monetary Fund	— 1.4	— .3	Nonrecurring expenditure proposed to be made in fiscal 1959
Farm price support activities	— .9	— .9	Acreage reserve feature of soil bank program has been terminated
Mortgage purchase operations	— .7	— .6	Exhaustion of 1 billion dollar special authority granted in 1958 and proposed exchange of 335 million dollars of mortgages for Government securities
Postal deficit	— .6	— .6	Effect of last year's increases in postal rates, plus proposed further increases of 350 million dollars
Military assistance	— .5	— .7	
Unemployment insurance activities	— .4	— .9	Expiration of temporary program of expanded benefits passed in 1958, plus decline in unemployment
Net expenditures of Federal Home Loan Banks (Government-sponsored enterprises)	—	— .5	
Total of above	— 4.5	— 4.5	

*Less than 50 million dollar change forecast in Budget.

initial convening of Congress, is characteristically a retrospective review. In recent years, the message usually has concentrated on foreign affairs but has also outlined the Administration's legislative program. The details of this program are ordinarily left to the Budget and to special messages scheduled for later transmission. This year, the schedule includes messages on agriculture, civil rights, labor reforms, the mutual security program and veterans' benefits. Nevertheless, the President devoted nearly half of this year's State of the Union message to the problems of inflation, the Budget and Governmental costs.

The *Budget* message is of more recent vintage, dating from 1921. It is ordinarily presented about two weeks after Congress reconvenes and is primarily a set of forecasts and recommendations. It includes the Administration's financial program in detail, based on recommendations for legislation as well as the impact of the economy's anticipated performance on the Government's finances under existing legislation. This year, of course, the big news is the President's

	Change, 1959 to 1960 in Budget terms (billion dollars)	Change, 1959 to 1960 in cash terms (billion dollars)	Main reasons for change
Major increases —			
Interest	+ .5	+ .6	Higher interest rates plus higher average level of Federal debt
Highway aids	*	+ .6	Planned expansion under 1956 and 1958 highway acts
Benefit payments under Federal retirement and disability systems	—	+ 1.2	Increased numbers of beneficiaries and higher average benefits
Total of above	+ .5	+ 2.4	
Net change in all other programs	+ .2	+ .1	
Over-all change in expenditures	— 3.8	— 2.0	
RECEIPTS			
Individual income taxes	+ 3.8	+ 3.8	Personal income expected to rise 21 billion dollars during 1959
Corporation income taxes	+ 4.4	+ 4.4	Corporate profits expected to rise 8.5 billion dollars during 1959
Employment taxes	*	+ 2.0	Increase in employment and full-year effect of January 1, 1959 increase in social security taxes
Excise taxes	+ .5	+ 1.3	Increased sales of durable goods plus proposed increases in rates of taxes on gasoline and aviation fuels
Total of above	+ 8.7	+11.5	
Net change in all other receipts	+ .4	+ .3	
Over-all change in receipts	+ 9.1	+11.8	

prediction that, with the changes he suggests, the Federal Government will shift from a large deficit in the current fiscal year to a balanced position in the next fiscal year.

The *Economic Report* is a postwar newcomer. It is required under the terms of the Employment Act of 1946. Delivered shortly after the Budget is presented, it contains a verbal and statistical review of the economy's behavior in the preceding year, together with a wealth of historical data. It has also come to include a wide range of Administration legislative proposals on economic and financial matters, as well as suggestions for actions by state and local governments and the private sector of the economy. The 1959 Economic Report is devoted largely to a review of recession and recovery, with a forecast that "the recent improvement in activity will be extended into the months ahead." The last quarter of the Report, however, concentrates on the problem of achieving economic growth with price stability, with principal emphasis on the contribution that a balanced 1960-Federal Budget can make to the effort to preserve price stability.

Perspective on the Budget

The sheer size of the Budget is enough to explain the great interest in its impact. The Federal Government's purchases of goods and services in 1958 accounted for 12 per cent of the nation's total output. Furthermore, swings in the Federal fiscal position, at times, have been extremely wide, with major repercussions on the economy. During the past decade, there have been several major expansions and contractions in both Federal spending and Federal Government receipts, occasioned by changes in the international scene, in the tax laws and in the nation's economy. These swings have involved changes in total outlays or total receipts in a single year of as much as 20 billion dollars.

During the fiscal year which ended in mid-1950, just as the Korean war began, Federal Budget receipts and expenditures were each less than 40 billion dollars. The Budget submitted in January covering fiscal 1960 calls for receipts and expenditures to be balanced at the 77 billion dollar level. Total cash expenditures for fiscal 1960, which include social security and other "trust" operations but exclude transactions internal to the Federal Government, are estimated by the President at nearly 93 billion dollars, 115 per cent higher than a decade earlier.

Moreover, even the 93 billion dollar total does not fully measure the impact of the Government's cash transactions upon the economy. This is because some revenue-producing activities are reflected in the Budget only to the extent that their outlays exceed the applicable revenues. For example, the Budget totals reflect only the anticipated postal deficit, not the total outlays for the postal services. In all, net receipts from operations amount to at least 11 billion dollars. Total gross cash expenditures of the Federal Government in fiscal 1960 will probably approach 105 billion dollars.

Cycles in the Budget

The fiscal years 1956 and 1957 marked a big swing in Federal receipts and expenditures. Booming business activity produced increases in receipts of about 9 billion dollars in 1956 and 5 billion in 1957, bringing Federal cash receipts up to 82.1 billion, an all-time record to date. Defense outlays began to climb once more, in large part because of the increasing costs of maintaining the existing program. Nondefense outlays increased much more rapidly—by

about 7 billion dollars in the two years. Nearly all of the increase was accounted for by liberalized social security provisions, expanded housing and highway activities, and higher interest charges. Nevertheless, in fiscal 1956 and 1957, the Federal Government's operations produced cash surpluses which were timely contributions to the efforts to restrain inflationary pressures.

Since mid-1957, the Government has run a large deficit—the result of higher expenditures and lower receipts. In fiscal 1958 and in the current fiscal year, receipts have declined moderately due to the decline in business activity. Much more important has been the huge increase in cash expenditures, amounting to nearly 15 billion dollars. Cash expenditures this year are estimated to total nearly 95 billion dollars and the cash deficit is expected to exceed 13 billion dollars, far more than in any year in our history aside from the World War II period. In this two-year period the recession induced large increases in spending for some activities coincidentally with the large-scale expansion of other programs, some of a long-term nature. Among the increases largely attributable to the economy's slackening pace have been:

—an increase of 1.7 billion dollars in unemployment insurance benefit payments, to an estimated total of 3.4 billion this year;

—a net increase of 600 million dollars in various housing expenditures, to an estimated 1.6 billion; and

—an increase of nearly 2 billion dollars in farm price support expenditures, to nearly 5.4 billion.

Among the increases which were mainly occasioned by changes in legislation during 1958 and in earlier years, which involved longer-term Federal activities, are the following:

—an increase of 1.5 billion dollars in Federal highway aids, to a total of nearly 2.5 billion;

—an increase of 3.2 billion dollars in benefit payments under various Federal retirement and disability programs, to an estimated total of 10.9 billion;

—an increase of 400 million dollars in public assistance grants, to a total of nearly 2 billion; and

—an increase of nearly 400 million dollars in outlays on aviation facilities and research, to nearly 700 million.

Also, defense outlays have continued their climb and have risen by more than 3 billion dollars during fiscal 1958 and 1959. The deficit which results from these increases in expenditures, and from the decline in receipts, has enlarged the Federal debt and contributed to the increase in interest costs which are expected to be almost 400 million dollars higher than two years ago.

Fiscal 1960 and later

In his Budget message, the President forecast an improvement in the Government's fiscal position between the current fiscal year and fiscal 1960 of 13 to 14 billion dollars, resulting in small cash and Budget surpluses. This is a far greater shift than has ever occurred in a single year, the World War II period aside. As would be expected, a forecasted change of this magnitude has been criticized as unrealistic. How likely are these predictions to be borne out?

The major changes indicated in the Budget, together with the principal reasons for them, are spelled out in the accompanying table. It is clear that the budgetary balance depends to some extent on new legislative proposals which will both reduce net expen-

ditures and increase receipts. If neither the proposed increases in postal rates nor the suggested exchange of Government owned mortgages for outstanding Treasury obligations takes effect, net expenditures will be around 700 million dollars higher than forecast. If the proposed increased taxation of motor vehicle and aviation fuels is not enacted, receipts will be nearly 800 million dollars lower than forecast. Thus, proposed legislation accounts for around 1.5 billion dollars of the predicted improvement in the Budget outlook. But the overwhelming bulk, both of net declines in spending and of net increases in revenues, does not depend on problematical Congressional action. Rather, most of the changes will occur if the economy performs as the Budget assumes, without further changes in legislative arrangements. For example, declines in outlays for farm programs, unemployment insurance and mortgage purchases will result from the expiration of provisions enacted in earlier years and no longer on the books.

Changes in tax laws and in expenditure programs *not* proposed by the President are perhaps more likely to upset the delicate balance than failure of the Budget's predicted changes to occur. It is hardly a secret that there are persistent pressures for expansion of Federal spending in many areas. For example, as the President has pointed out, maintaining even constant levels of defense outlays requires considerable efforts in the face of the increasing complexity and costs of modern weapons. Moreover, in recent years the Federal Government has been faced with the same kinds of demands for expanded nondefense services that have confronted state and local governments throughout the postwar period. Since 1946, the private sector of the economy has shown tremendous growth. Pressure for improvements in the quantity and quality of publicly produced services in the fields of education, transportation, housing, health, welfare and community facilities is in part an outgrowth of this expansion in the private sector.

In fiscal 1960, at any rate, such pressures are unlikely to increase expenditures significantly, since newly enacted programs typically require some time to take full effect. The educational aids proposed by the President in mid-February, for example, might ultimately lead to substantial Federal outlays, but not in the next fiscal year. In a sense, the controversy over the Budget in any one year is a controversy over Federal spending not in the coming fiscal year but over the next two, five or ten years.

Programs already enacted or included in this year's "balanced" Budget will no doubt spell higher total Federal spending in fiscal 1961 and 1962, even if no further expansion of the programs is provided by Congress. Thus, the Budget message estimates that commitments for Federal outlays for capital improvements in urban communities outstanding at the close of fiscal 1960 will exceed 6 billion dollars, compared with estimated expenditures for these purposes in 1960 of around 2 billion.

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